# Consultation Response

StepChange Debt Charity

## Assessing creditworthiness in consumer credit Proposed changes to our rules and guidance

## Consultation Paper CP17/27

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## Introduction and general comments

StepChange Debt Charity is the largest specialist debt advice charity helping people across the UK. In 2016 we were contacted by almost 600,000 people seeking debt advice.

We welcome the opportunity to respond to this consultation paper (CP) as creditworthiness assessments, particularly the affordability element of these, are an essential tool to prevent households from falling into problem debt. Therefore we welcome the changes in the rules particularly on making affordability a more explicit element of creditworthiness assessments. However, we are still concerned that it is uncertain how these changes as a whole will make a significant enough impact to tackle current issues with responsible lending.

As an overall comment, the approach to creditworthiness and affordability as outlined in this CP is generally reactive rather than a more proactive, preventative approach. This approach gives firms a lot of flexibility and leeway to make their own decisions on creditworthiness and affordability. However, the FCA's own analysis has shown that giving firms this leeway where it is not aligned with financial incentives and has resulted in negative consumer outcomes. For example, the Credit Card Market Study findings on the extent and levels of persistent credit card debt. The concern is that in taking action only when problems have occurred is too late and a focus on a more preventative approach would be more effective.

An example of this in this consultation paper is where firms consider that it is 'obvious' the credit is affordable they do not have to establish the customer's income and will only have to demonstrate they had a reasonable basis for this view if challenged. This gives firms considerable leeway to make their own judgement on whether the credit is obviously affordable and they will only have to justify this view if challenged by the FCA. We are concerned this leaves a regulatory gap that, when coupled with incentives for firms to lend where credit is unaffordable (as outlined in table 1 of the CP), may create a space for poor lending practices. A more preventative approach would add in safeguards and seek to stop customer detriment before it occurs rather than just identifying and taking action after the fact.

We are also particularly concerned about affordability issues in the mainstream credit market specifically with overdrafts and credit cards. The Credit Card Market Study found that there are around 3.3 million people in persistent credit card debt and that where persistent debt is profitable, firms have little incentive to intervene. These findings suggest that in some cases firms have little incentive to adequately assessing affordability in order to prevent borrowers from falling into persistent debt. One specific concern is that the structure of credit card lending, with low minimum repayment requirements, disincentives responsible lending.

Similarly with overdrafts, this CP has not focused on a significant, current issue where consumers are given large overdrafts that they are likely to struggle to repay. This then can result in these consumers falling into persistent debt which may be profitable for firms but is detrimental to these consumers. We are also particularly concerned that unarranged overdrafts are not currently subject to creditworthiness assessments. We would urge the FCA to look particularly at issues of affordability and sustainable lending further with regards to overdrafts and credit cards. Action should be taken to increase minimum payments on credit cards and address the lack of creditworthiness assessments with unarranged overdrafts.

Our final overall comment is to raise questions about the figures on the number of people in financial distress in the consultation paper (page 24). These found that around 2.2 million people with a consumer credit product were in moderate or severe financial distress. We are concerned this may underestimate the levels of people in financial difficulties. Our research found that 2.9 million people are struggling with severe debt problems and over 9 million more are showing signs of financial distress. The Money Advice Service has similarly found that 8.3 million individuals are over-indebted as they find keeping up with their bills and credit commitments a 'heavy burden', or that they have missed payments for bills and/or credit commitments in three or more of the last six months.

## Questions

**Q1: Do you agree with our proposed changes to the scope of the creditworthiness rules and proposed transitional arrangements?**

Our comments on the proposed changes to the scope of credit worthiness rules are as follows:

On the changes in relation to pawnbroking agreements we understand that the FCA considers these lower risk as the liability is linked to the value of the goods. Generally we would agree with this assessment where these agreements have a limited liability and debts cannot become persistent. However that is not to say that pawnbroking agreements cannot be a part of an unaffordable cycle of borrowing. For instance, there could be risk of further financial distress where people borrow against items of emotional value (e.g. their wedding ring) and then turn to other credit products to meet their commitment under a pawnbroking agreement. So while it might be reasonable to exempt pawn agreements from the creditworthiness rules, the FCA should at least consider a tailored requirement for lenders to consider the possibility of negative financial consequences arising from a pawn broking agreement.

The consultation paper states that the rules on creditworthiness do not apply to unarranged overdrafts in line with European law (the CCD). We also understand that the FCA is considering unarranged overdrafts more generally as part of the review of high-cost credit. However, we are concerned that with the consultation on overdrafts as part of this review is not coming out until Spring 2018 and therefore any action on unarranged overdrafts is not likely to come into force until late 2018/early 2019. We see the impact that unarranged overdraft charges have on our clients and how these charges can exacerbate their financial difficulties.

Therefore we would ask the FCA to take some action on overdrafts ahead of this review. Firms are required to do a creditworthiness assessment on authorised overdrafts. If this assessment is effective then consumers should not be regularly falling into unarranged overdraft. The FCA should consider adding into CONC rules a requirement on lenders to consider falling into unarranged overdraft to be an indicator of financial stress. Firms should be required to investigate and where necessary intervene to provide support for those in financial difficulties. This support should include suspending further charges, separating the overdraft debt from the transactional banking facilities, offering a basic bank account and an affordable way to repay their debt. This would prevent additional charges pushing more potential vulnerable consumers into further financial distress.

**Q2: Do you agree with our approach to the meaning of affordability and the factors that should be taken into account by firms?**

We support action by the FCA to clarify and make more explicit that creditworthiness includes not just credit risk to the lender but also affordability for the borrower. This is important as the experience of our clients shows unaffordable lending causing detriment whether it is multiple payday loans, persistent overdrafts or credit card debt.

On the factors that should be taken into account by firms, in cases where a customer indicates they want to repay using savings or other assets the firm has to take account of the purpose of those savings and assets and any significant negative impact on the customer's financial situation of using them to repay. However, we would also ask whether the lender should be required to assess the reasonableness of the borrowers repaying out of savings and assets.

This is a particularly relevant to rent to own lending as this lending secured on, often essential, household goods is similar to lending against an asset as repayment. The All Party Parliamentary Group (APPG) on Debt and Personal Finance Inquiry into the rent to own sector raised concerns about inadequate affordability assessments leading to significant levels of payment problems. We understand the FCA has been looking into creditworthiness and affordability assessments in the rent to own sector. We would urge the FCA to strengthen affordability assessments in this sector and to require firms to explain the full costs and possible alternatives.

On the other factors that should be taken into account by firms, one is the risk to the customer not being able to make repayments 'without the customer having to borrow to meet the repayments or being unable to meet other financial commitments'. We currently see cases where lenders have granted credit to people who were already unable to meet their financial commitments. These existing borrowing commitments should have alerted lenders to the very strong probability that further credit would not be affordable. This suggests that firms are not just misunderstanding the rules but are lending where there is clearly a high risk of a negative outcome on the financial situation of the borrower. For example, these were responses to a client survey undertaken in August 2016 of those who had applied for high cost, short-term credit (HCSTC) after January 2015:

*"I had multiple loans out with them and other lenders."*

*"I should have not been lent the amount as I already had a huge amount of credit to repay to other creditors."*

*"I was in a lot of debt anyway and the payday loan tipped me over the edge."*

A key question is how the FCA is going to ensure that the lenders are properly assessing the risk of lending to those who are already unable to meet their other financial commitments. We would welcome more clarity on this.

**Q3: Do you agree with our proposals on the use of income and expenditure information?**

The proposals are to not require lenders to estimate or establish the customer's income where it can demonstrate that it is obvious that the credit is affordable. We have concerns about that this may not adequately safeguard against unaffordable lending.

The FCA gives the example that lenders can base their decision on whether it is 'obvious' on the basis of a CRA check. Therefore lenders could decide that credit is affordable based on just one CRA's data. However, as the Occasional Paper 28 found this can result in an 'incomplete picture' of the credit applicant's debt as there is large differences in the contents of data between CRAs. Even if the lender uses more than one CRA, it is unlikely they will be able to get a full picture of the potential borrower's situation as some lenders only report to one of the CRAs. This rule would give lenders the ability to not undertake a full assessment of creditworthiness and affordability based on incomplete information.

There is also the issue that some lenders may not be interrogating the data fully for signs of possible financial difficulty. Firms may decide that as there is no 'negative' data on CRA files and the borrower is keeping up with their payments that the credit is obviously affordable. However, this may not be the case where the existing payments are already placing a heavy burden on the potential borrower in relation to their income level. The Credit Card Market Study findings on the levels of persistent debt are an example suggesting that firms are not doing enough to identify cases where borrowing may be unaffordable.

Allowing lenders to pay less concern to affordability where they consider this 'obvious' is also concerning as we currently see examples of unaffordable lending to our clients. These are examples we have seen with overdraft lending where our clients were having to use credit to manage their everyday essential costs and where they turned to lenders for help with financial difficulties but were offered more credit:

**Case study:**
A client was offered a £2,250 overdraft by his bank even though he only worked part-time and received £200 a month in wages and his only other income was from universal credit.

**Case study:**
A client was able to extend her overdraft 16 times over a 30 day period, she was also given a loan by the same bank which she increased from £5,000 to £25,000 over a 10 day period. Her first payment is due and she will be unable to make this as it is over £400 and she only works part time with the rest of her income from child support, child benefit and tax credits. FOS are investigating this case.

**Case study:**
A bank gave our client an £5,000 overdraft despite her only earning between £500-£600 a month. The client believed she should never have been given an overdraft of that amount based on her income.

Leaving it to lenders to assess whether it is ‘obvious’ that credit is affordable is problematic as the FCA acknowledges firms “may not have a sufficient incentive to incorporate affordability aspects into their assessments”. For example, as displayed in table 1 in the consultation paper there are cases where credit applications are accepted where the credit is unaffordable as they are profitable for the lenders. Therefore we do not agree that lenders should not have to estimate or establish the customer’s income where it is considered ‘obviously’ affordable.

If this proposal is to be implemented, FCA rules should be more prescriptive to ensure that the responsible lending rules as a whole are preventative rather than reactive. There is a need to ensure that if credit is not affordable for the borrower this is picked up an early stage rather than when they start falling behind on various payments. This prescription could include requiring firms to use the credit data to impute existing payment burdens and take them away from disposable incomes to get a clearer picture of whether the credit applied for is to be considered obviously affordable.

There also needs to be better safeguards for the assumption that it is affordable than the ones proposed e.g. CRA data or small amounts of low cost credit. There is a suggestion that small amounts of credit from prime products may meet this definition but for many of our clients, credit card and overdraft borrowing build up into persistent debt. There needs to be clearer guidance and detail more detail on what is considered ‘obviously’ affordably and on considering signs of financial pressure within this.

**Q4: Do you agree with the factors which we propose that firms should have regard to when considering proportionality of processes for assessing creditworthiness including affordability?**

There is currently guidance in CONC (5.2.3 G and 5.2.4 G) on factors to take into account with regard to proportionality for assessing creditworthiness and affordability. However, we still see evidence that firms are not adequately assessing affordability across both prime products such as overdrafts and credit cards and high cost products such as in rent to own and HCSTC. The question is whether these new rules intended to clarify proportionality will prevent this unaffordable lending without further clearer and more prescriptive guidance.

In terms of the factors proposed in the new rules, they are focused on the risks to the lender and the risk of the borrower falling into financial difficulty. They do not cover the risks of wider negative consequences from the borrowing e.g. borrowers keeping up with payments but falling into persistent debt or borrowers repaying credit repayments but getting behind on essential bills. This is particularly an issue, for example with credit cards where making minimum repayments mask wider financial problems. The list of factors should be more borrower focused, including whether there is evidence that the borrower is in persistent debt with the firm or another firm. This could also include looking at the circumstances of the borrower and how this product has worked for similar borrowers.

One of the factors proposed is the ‘type of credit’. We think there should be more clarity about what is meant by this as it is unclear whether the type of credit means running-account credit or fixed credit or if it means in relation to the cost of the credit e.g. high cost credit vs mainstream.

The lender should also take into account any information indicating that the customer is particularly vulnerable or has recently experienced financial difficulties. However, the lender is not expected to proactively establish whether such vulnerabilities exist as this would be 'disproportionate'. We would suggest that more onus should be placed on lenders to establish whether potential customers are vulnerable and appropriate action taken should be in relation to creditworthiness assessments based on this information.

**Q5: Do you agree with our proposals for open-end and running-account credit, guarantor loans and peer-to-peer loans?**

On running-account credit, there is currently a rule requiring firms to consider the ability of the customer to make repayments within a reasonable period for open-end agreements [5.2.1 R (2)] and guidance on having regard to the typical time required for repayment of a fixed sum loan [5.3.1G (8)]. Despite this currently firms are not always adhering to the responsible lending rules. Credit card minimum repayment requirements mean that firms can still offer unsustainable credit balances that are repaid over a long period time. This then can lead to the build-up of persistent debt. We are concerned that the proposals on running-account credit are currently found in a different form in CONC rules but they are not effectively preventing persistent debt as evidenced by the findings of the FCA credit card market study.

There needs to be more clarity on what a 'reasonable period' is with regards to running-account credit. The example given is that firms should consider the typical period of repayment of a fixed sum loan for equivalent amount of credit. However, the time period for fixed sum loans can vary considerably and be anything from one to five years or longer.

We would suggest that the FCA should be more specific in the definition of a reasonable period. The FCA is clearer on acceptable timescales of lending in their existing and proposed rules in other areas. For example, high-cost short-term credit is defined as within 1 year. Moreover, the FCA consultation paper 17/10 presents the definition of persistent credit card debt as where a customer pays more in interest and charges than they have repaid of the principal over a period of 18 months. This suggests that anything over 18 months is considered an unreasonable period to be in persistent debt with a running account such as a credit card.

In our response to the call for input on high cost credit we suggested the need to strengthen creditworthiness assessments for guarantors so we welcome the new rule requiring firms to assess potential impacts on a guarantor (CONC 5.2A.31 R). We also welcome that the new guidance on this rule (CONC 5.2A.32G) outlines that in deciding what steps should be taken to make the assessment under CONC 5.2A31R the total potential liability of the guarantor under the guarantee is included.

On peer-to-peer lending, we welcome that there will be a separate requirement for peer-to-peer platforms to undertake a creditworthiness assessment under CONC 5.5A in order to ensure further protection for borrowers. We also agree with the proposal to address the gap in the regulations by extending the creditworthiness requirements to include a significant increase in the amount of credit or the credit limit under a peer to peer agreement.

**Q6: Do you have any views on our proposals in relation to firms' policies and procedures for creditworthiness assessment?**

We welcome the clarification that policies and procedures must be in writing, although we are surprised that further clarification is needed on this point. We also think it is sensible to require firms to assess and periodically review the effectiveness of these policies and procedures and take measures to address any deficiencies. This should enable improved FCA supervision of creditworthiness assessment policies.

As part of this review firms should establish the number of their customers who are in arrears or default and look into the circumstances of these customers when they came to them. This could help them to identify if there are any patterns of unsustainable lending and where they need to address deficiencies.

**Q7: Do you have any views on the use of CRA data and products, or other data sources, as part of an assessment?**

We are concerned that Occasional Paper (OP) 28 found various issues with CRA data. One issue was that with a number of different CRAs there is not one single record that lenders can access to see all the data pooled together. As OP 28 says as there is incomplete coverage and consulting just one CRA can understate the current debt levels and repayments of a potential borrower. If the main aim of using CRA and other data and products is to ensure responsible lending then getting a less than complete picture from these sources is problematic. The FCA should investigate this issue further and come up with a broader solution to ensure complete visibility of debt levels and repayments of potential borrowers. This could include considering the approach of bringing together all the data into one single CRA.

There is also the issue that firms are not necessarily using the data from CRAs effectively to make informed, responsible lending decisions. As we have stated earlier, some lenders may just be looking for 'negative' signs of current financial difficult on credit files. They may not be fully reviewing the wider financial pressure the potential borrower may be under to establish whether they will be able to afford to repay the credit. The FCA should investigate this further and set out how they will ensure firms are making use of the CRA data in order to properly assess affordability.

Another of the issues with CRA data found in OP 28 is that it is not always up-to-date. This is particularly an issue with regards to real-time data sharing in HCSTC. Real-time data sharing is essential to ensuring that that HCSTC is lent responsibly, based on full information about a customer's financial commitments. In PS14/16 in November 2014, the FCA stated that the majority of the HCSTC market (around 90%) was participating in real-time data sharing. However, as OP 28 indicates some CRAs data is still around 1-2 months behind. We also understand that there was previously a proposed requirement for firms to report in real-time to at least two bureaus but that this was changed to one. As there are still significant issues, we would urge the FCA to take action and mandate real-time data sharing across the whole of the HCSTC market.

**Q8: Do you have any other comments on our proposed changes to CONC in relation to creditworthiness including affordability?**

The next steps section of this consultation includes a section on cold calling. This is an area where both Government and the FCA have given commitments on a review and consultation on cold calling. On November 26th 2014, Baroness Neville-Rolfe, then Parliamentary Under-Secretary (Department for Business, Innovation and Skills), committed the FCA to consulting on unsolicited marketing calls **in 2015**. *'As part of the FCA's clear and ongoing plan to tackle sources of consumer detriment in the payday loan market, next year it will consult on payday loan firms' unsolicited marketing calls. This consultation will be undertaken in the early summer, following the closure of the authorisation "landing slot" for payday loan firms. The FCA has written to me committing to this, and I am happy to place its letter in the Library of the House. The consultation will specifically include looking at whether these calls should be banned. The FCA will also take a close look at payday loan firms' use of other unsolicited communications, including text messages and e-mails.'*

- By October 29th 2015, according to Baroness Neville-Rolfe, that review had moved to **early 2016**. *'The FCA has committed to undertake a proper review of its rules on unsolicited marketing calls, emails and text messages from consumer credit firms…It will take place early next year.'*
- On November 11th 2015, Lord Ashton of Hyde, speaking for the Government during the Committee stage of the Bank of England and Financial Service Bill, confirmed the review would occur by **early 2016** *'Importantly, the FCA has already committed to undertake a review of unsolicited marketing calls, emails and text messages from consumer credit firms, which will begin early next year.'*
- However, once we reached October 10th 2016, Lord Young of Cookham, speaking for the Government during a Lord's debate on High-Cost Credit and Debt Management, was only promising the emergence of an FCA review on cold calling **by the end of 2016**. *'The Financial Conduct Authority is currently reviewing its consumer credit rules in relation to cold calling, particularly to high-cost credit and debt management, and expects to publish the outcome of the review by the end of the year.'*

It appears that the promised review on cold calling has emerged as a short section in this creditworthiness consultation where the FCA concludes that ' it has considered whether the rules address the problem and are prompted to 'consider whether to do some future work on general issues relating to cold calling and unsolicited marketing. While such consideration is welcome, it does not look to us like the outcome of the review promised to parliament. This response is especially concerning given the evidence we previously presented on the cold calling problem. This showed people in financial difficulty being targeted by companies providing high-risk credit products. A survey of 1,177 StepChange Debt Charity clients between January and April 2016 found:

- A third (32%) said they had received an unsolicited marketing call offering them a payday loan. Those receiving calls received an average of over five calls per week.
- Over 12% of clients offered a loan had taken out high cost credit as a result of one of these unsolicited telephone calls. The additional high-cost credit taken out by these clients averages £1,052.

Our national polling from April 2016 found more than half of adults in Britain (29.5 million people) receive unsolicited phone calls offering high-risk financial products and around one in eight are being called every single day.

The research shows these calls, which offer products like high cost credit (e.g. payday loans) and fee-charging debt management services, have resulted in 1.5 million people taking out one of those two products.

**Q9: Do you agree with our assessment of the costs and benefits of the proposed changes?**

We have no comment at this time

**Q10: Do you have any comments on the equality and diversity implications or other aspects of our proposals?**

We have no comment at this time